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Supreme Court of the United States

OCTOBER TERM, 1968

No. 465

IN THE MATTER OF:
LIGHTING CENTER, INC., BANKRUPT

IN RE:
A. M. FAUCETTE, JR., TRUSTEE IN BANKRUPTCY,
PETITIONER,

versus

MRS. RUTH K. VAN DOLSON, RESPONDENT

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE FOURTH CIRCUIT

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The Trustee in Bankruptcy as Petitioner hereby petitions this Honorable Court to issue a writ of certiorari to review the decision of the United States Court of Appeals for the Fourth Circuit, entered June 6, 1968.

OPINIONS BELOW

The controversy between the parties arising out of a proceeding in Bankruptcy has been before the United States Court of Appeals for the Fourth Circuit on two occasions on appeals by Petitioner, the first resulting in a remand, *Faucette, Trustee v. Van Dolson*, 360 F. (2d) 611, dated May 2, 1966, printed in the Appendix at page 26; and the second not reported to date, opinion printed in the Appendix at page 38.

Upon belief, the Orders of the District Court dated December 18, 1967, and July 6, 1965, are not reported but are printed in the Appendix at pages 34 and 25, respectively. Likewise the Reports of the Referee in Bankruptcy dated June 28, 1967 and June 21, 1962, are not believed reported, but are printed in the Appendix at pages 28 and 23, respectively.

JURISDICTION

The decision sought to be reviewed was filed on June 6, 1968.

The jurisdiction of this Court to review that decision by writ of certiorari is conferred by 11 U.S.C., Section 47 (c) in conjunction with 28 U.S.C., Section 1254 (1) and 28 U.S.C., Section 2101 (c).

QUESTIONS PRESENTED FOR REVIEW

1. Whether in a matter of first impression in South Carolina, the Courts below should be permitted to engraft elements as prerequisites for invalidating a chattel mortgage which are not patently in the language of Sections 45-155 and 45-156, Code of Laws of South Carolina, instead of being required to construe the language literally, as indicated by all available evidence of precedent.

2. Did the Court below so misinterpret and misapply the applicable law of South Carolina relating to the validity of a corporate transaction involving participation therein by interested officers and directors as to constitute a conflict with said applicable State law?

STATUTES AND BY-LAWS INVOLVED

1. With regard to Question 1:

Section 45-151, Code of Laws of S. C., 1952, Vol. 4, p. 864.

45-151. Descriptions in chattel mortgages.

No chattel mortgages, except (a) mortgages or deeds of trust covering the whole or any part of the real or personal property of a public utility company, hydro-electric company, railroad company or manufacturing company, (b) chattel mortgages executed to a production credit association or to the governor of the Farm Credit Administration, or (c) mortgages executed by the State Rural Electrification Authority or by a cooperative organized under or subject to the provisions of the Rural Electric Cooperative Act (chapter 15 of Title 12), shall be valid or good to convey any interest or right whatever to the mortgagee unless the property mortgaged shall be described in writing or typewriting, but not printing, on the face of the mortgage, nor shall any prosecutions lie for selling any property under the lien of such mortgage unless the property mortgaged shall be described in writing or typewriting, but not printing, on the face of such mortgage.

Section 45-152, Code of Laws of S. C., 1952, Vol. 4, pp. 864-865.

45-152. Requisites of mortgages of crops, etc.

No mortgage shall be good and effective to convey to the mortgagee an interest in or create a lien on any crop, truck or fruit of any kind or description, other than that

which shall be planted or grown within one year from the date thereof, nor unless such crop, truck or fruit together with the land whereon the same is or will be planted or grown shall be described therein. But a mortgage which complies with the foregoing provisions hereof, when indexed or recorded as required by law, shall constitute from its filing for record a prior lien on any crop, truck or fruit therein described, whether or not it shall be at that time or thereafter planted or growing, in preference to a subsequent mortgage thereon and to the lien of any judgment or execution issued thereon.

Section 45-155, Code of Laws of S. C., 1952, Vol. 4, p. 866:

Section 45-155, Unlawful to take Mortgage for greater amount than actually lent.

It shall be unlawful for any such lender of money, his agents, employees, or any person in his behalf, to have inserted in his mortgage or bill of sale, as representing the indebtedness of the mortgagor or vendor, an amount in excess of the actual amount of money received by the borrower, except as provided for in 45-153 and 45-154 and recording fees. (Sections 45-153 and 45-154 are not applicable in this case.) (Parenthetical information supplied.)

Section 45-156, Code of Laws of S. C., 1952, Vol. 4, p. 866:

Section 45-156. Certain Mortgages void.

All mortgages or bills of sale given as security for loans in or on which such charges have been made or which on the face shall show an indebtedness greater than the amount actually received by the borrower in violation of Section 45-155 are hereby declared null, void and of no effect.

1949 Rev. S. Conn. 7279 (revised 1958 G. S. Conn. 49-107, and repealed 1961 replaced by Uniform Commercial Code) entitled "Certain Chattel Mortgages void. Penalty":

Any person who shall loan money upon a note secured by a mortgage upon personal property, in which the sum of money loaned is stated to be greater than the amount actually loaned, or in which the rate of interest to be charged is greater than the rate allowed by law to be charged by pawnbrokers, shall be fined not more than fifty dollars or imprisoned not more than three months or both; and the mortgage and note secured thereby shall be void.

2. With regard to Question 2:

Section 12-102(4), Code of Laws of S. C., 1952, Vol. 1, p. 1063.

12-102. Powers of corporations organized under chapter two.

Every corporation chartered under chapter two of this title shall have the following powers, to wit:

(4) To borrow money for the purpose of carrying out the objects of its charter, to make notes, bonds or other evidences of debt and to secure the payment of its obligations by mortgage or deed in trust on all or any of its property and franchises, both real and personal, when so authorized by resolution of its board of directors or managing board.

By-Laws of Lighting Center, Inc.

ARTICLE 1.

The officers of the corporation shall be a President, a Vice-President, a Secretary and a Treasurer. The officers shall serve as directors and shall constitute the Board of Directors.

ARTICLE 6.

. . . The majority of a Board of Directors shall constitute a quorum provided that such majority shall represent 84% of the outstanding stock of the corporation. Special meetings of the Board of Directors may be called by the President upon one days notice but such special meeting may be held at any time with unanimous consent of the directors.

ARTICLE 7.

. . . Eighty-four per cent of the outstanding stock shall constitute a quorum of all meetings of stockholders.

ARTICLE 8.

A majority of the quorum, whether stockholders or directors, may decide any question coming before the meeting. . . .

ARTICLE 9.

• • • •

The credit of the Corporation shall not be pledged nor any purchase be made nor shall any sale of the property of the Corporation be made except upon vote of the Board of Directors accepting merchandise for resale or any properties or moneys of the Corporation of lesser value than Fifty ($50.00) Dollars.

STATEMENT OF THE CASE

The facts material to the consideration of the questions presented and as heretofore found, admitted, stipulated by the attorneys for the parties, or testified to by the Van Dolsons are as follows:

At a corporate meeting held on March 5, 1960, Robert Van Dolson, husband of the Respondent, Ruth K. Van Dolson, purchased the interests of three stockholders in a South Carolina corporation known as The Lighting Center, Inc., which was incorporated on October 28, 1959, and

which was insolvent almost from its beginning. At this time he then held two-thirds of the issued stock and one Meyers held the remaining one-third.

On the same evening immediately subsequent to the purchase of these interests, Van Dolson, Meyers, and the one attorney representing the corporation, Meyers, and Mr. & Mrs. Van Dolson met and conferred as to the operation of the business: Meyers was named President and General Manager; Van Dolson, Secretary and Treasurer, and Mrs. Van Dolson, Vice-President. The By-Laws provided that each officer was a member of the Board of Directors.

At this particular meeting, as reflected by the Minutes, by unanimous vote, the officers "were authorized and empowered to negotiate for the loan of a sum of money from Ruth K. Van Dolson, and . . . to make, execute and deliver to Ruth K. Van Dolson a promissory note and chattel mortgage to secure payment of said note to Ruth K. Van Dolson upon such terms and conditions as said officers and Ruth K. Van Dolson should agree . . ."

The By-Laws provided that corporation credit should not be pledged except upon vote of the Board of Directors, 84% of the stock being necessary to constitute a quorum of the Board to transact business.

Van Dolson, while acting for the corporation, was representing and concerned with the interests of himself, his wife, and both jointly in requiring a chattel mortgage, and had an interest and concern in the outcome.

The note and mortgage at issue were actually executed by Meyers and Van Dolson as officers on March 22, 1960, and backdated to March 5, 1960. The note and chattel mortgage securing same recited and required payment by August 1, 1960 of $10,676.40 with interest at 6% per annum from March 5; and the mortgage was recorded in the office of the Clerk of Court of Sumter County on March 23, 1960,

creating a lien over all present and after acquired tangible personal property of the corporation.

On March 22, 1960, Mr. Van Dolson himself personally drew a check for only $10,000.00 on a checking account he maintained jointly with his wife, and deposited it to the corporation account, from which some existing creditors were paid, many not being paid, and there being no proration. The note and chattel mortgage at issue for $10,676.40 were given to Mrs. Van Dolson to secure this $10,000.00.

On August 2, 1960, Mrs. Van Dolson notified creditors she was foreclosing her mortgage. An Involuntary Petition in Bankruptcy was filed against the corporation, and by agreement of counsel the foreclosure sale was postponed.

Subsequently, the Trustee obtained appraisals of the inventory and based upon average cost appraisal of $14,734.81 and average present forced market value of $10,318.35, the Court approved a sale for $8,000.00, payable to the mortgagee or Trustee, depending upon final determination in this case.

Thereafter, during the course of administration, the Trustee objected to the validity of the chattel mortgage as the basis of a secured claim on several grounds founded on State law and precedent, among them those included in the questions advanced in this Petition. Full hearing by consent and appearance of all parties thereby vesting jurisdiction per 11 U.S.C., Sections 46, 66, and 110 (e) was held thereon by the Referee in Bankruptcy, whose report holding the chattel mortgage valid and allowing Respondent secured status, was affirmed by the District Court. On appeal by the Trustee, the United States Court of Appeals for the Fourth Circuit vacated the Order of the District Court and remanded the cause to the District Court for recommitment to the Referee for the reasons and purposes stated by it (*Faucette, Trustee v. Van Dolson*, No. 10,240, 360 F. (2d) 611, dated May 2, 1966.) Thereafter, the Referee issued

his Order of June 28, 1967, again sustaining the chattel mortgage and the District Court affirmed by its Order of December 18, 1967. This Petition now seeks review and ultimate reversal of the said judgment of the Court of Appeals filed June 6, 1968.

ARGUMENT

Petitioner is informed and believes that as fiduciary for the unsecured creditors whose rights must depend upon the Federal Judiciary in this controversy in bankruptcy, he is entitled for two principal and important reasons to have this Court fully review the judgment below and grant appropriate relief:

I. The interpretation of Secs. 45-155 and 156, Code of Laws of South Carolina, 1952, is a matter of first impression in South Carolina. Without the citation of or reliance upon a single legal precedent by the Court of Appeals, the District Court or the Referee; in fact, contrary to all available evidence of legal precedent as to the probable interpretation of the existing State law; and in direct conflict with the interpretation by Court of Appeals for the Second Circuit of an almost identical Connecticut Statute, the Court of Appeals for the Fourth Circuit has sustained other than a literal construction of a most important and integral part of the South Carolina Statutes regulating the lending of money upon chattel mortgage security. This should therefore require the exercise by this Honorable Court of its power of supervision, review and decision before these extra elements not patently intended by the Legislature of South Carolina are permitted to stand engrafted by the decisions below upon the statutory scheme as binding precedent for the future.

In brief, Sections 45-155 and 156 of the Code of Laws of South Carolina, 1952, invalidate a chattel mortgage which shows on its face (here $10,676.40) an indebtedness greater

than the amount actually received by the borrower (here $10,000.00). On the first appeal the Court of Appeals remanded to be "better advised of the meaning and effect of the pertinent South Carolina law."

The Referee specifically concluded that: "If these Statutes be construed literally, then Mrs. Van Dolson does not have a secured claim." However, without citing any legal basis or precedent; or even explaining away the evidence of precedent advanced by the Trustee, he merely opined that the South Carolina Supreme Court would hold that there must be an intent to violate the Statute before a security instrument contrary to their terms would be held null and void.

The District Court dodged the legal issue and interpretation problem completely by rendering no opinion or citing no authority as to the probable South Carolina law on the subject, and in fact misinterpreting completely the cases cited by the Trustee by stating that "fraud was an element" in those cases although a reading of same shows this to be erroneous. He preferred to discuss good faith and so called scrivener's error or mistake of which there is not one item of evidence in the testimony if it be read.

Then, the Court of Appeals relied upon the familiarity of the District Court, and by inference of the Referee, as to the State Statutes and decisional law, although neither cited any; and asserted in its opinion that "no different interpretation of the laws of South Carolina by her courts is cited to us." All of the foregoing despite, contrary to, and the ignoring of, cogent, competent, and weighty evidence that there would be a literal interpretation by the South Carolina Supreme Court; and that intent, mistake or any other element would not be engrafted upon the language of the Statutes which have been in effect since 1904 and found in the 1962 Code under the same numbers.

The first item of evidence indicating that they would be literally construed can be seen in the case of *Rose v. Harlee,* 69 S. C. 523, 48 S. E. 541, decided in 1904. This decision by the Supreme Court of South Carolina involved a determination of the meaning of Section 45-151, which apparently was passed close in time to the Sections at issue by the Legislature to regulate chattel mortgages executed in the State, and which has been carried through the years as part of a statutory scheme under the same chapter.

In that case, the Plaintiff brought action to recover certain property described, including crops. Among other defenses, the Defendant took the position that the mortgage was void as to the crops because they were described in print and not in writing or typewriting. After an adverse verdict against the Defendant, the trial court granted a new trial on the basis that "It is manifest from a casual inspection of the paper that it does not comply with the terms of the act." The South Carolina Supreme Court agreed, thereby placing a strict literal interpretation on Section 151. It also found the act declaring such mortgage invalid "was passed for the protection of the public." It adopted the language of this Court in *Pullman Palace Car Co. v. Central Transportation Co.,* 171 U. S. 151, 18 Sup. Ct. 808, 43 L. Ed. 114, which said "They (numerous cases) are substantially unanimous in expressing the view that in no way and in no channels, directly or indirectly, will the courts allow an action to be maintained for the recovery of property delivered under an illegal contract where, in order to maintain such recovery, it is necessary to have recourse to that contract." (All Emphasis supplied.)

The foregoing is about as literal an interpretation as could be found. The Court specifically stated that statute was passed for the protection of the public, and that individual action could not defeat the public policy of which the statute is the expression.

The second item of evidence from the South Carolina decisions indicating that literal enforcement is called for here, while not concerning a statute as strongly worded as the one in issue here, but still part of the chattel mortgage scheme, is the case of *Kimbrell Co. v. Mills & Young Co.*, 100 S. C. 421, 84 S. E. 996, decided in 1915, dealing with a Section, now 45-152.

The Court had to determine whether a description of

> "all my crop of cotton, cotton seed, corn, hay, oats, and all other crops of whatever character now planted and to be planted by me during the year 1913"

was sufficient compliance. The Supreme Court adopted the Circuit Judge's Order as its opinion, in which the Order held that the mortgagee must lose, because the mortgage did not meet the requirement of the statute since it **did not describe or mention the lands.** (Emphasis added.)

Certain language of the case at p. 998 would seem to be appropos:

> "... **Unless the express terms of this statute are to be abrogated by judicial legislation,** it must be held that the record of a mortgage of future crops, which neither describes nor mentions the lands upon which the same are to be grown, is not constructive notice to subsequent bona fide purchasers for value without actual notice of such mortgage, and that the same is not good nor effective against such a purchaser. **To hold otherwise would be to disregard the plain language of the enactment,** which declares that 'no mortgage shall be good and effective to convey to the mortgagee any interest in any interest in any crops unless the land whereon said crops are to be raised shall be described or mentioned in said mortgage' ... If it were held that the reference to 'my crops' was sufficient without any description or mention of the lands upon which they were to be grown, **such a holding would manifestly nullify the statutory requirement that the land must be described or at least mentioned,** or otherwise that no such mortgage shall be

'good or effective to convey to the mortgagee any interest in such crops.' The statutory provision does not say that the existence of the land may be inferred; but, on the contrary, the express requirement is that it must be described or mentioned . . . Failing of such description or mention of such lands, **the positive provision of the statute is that no such mortgage shall be good or effective** to convey to the mortgagee any interest in the crops sought to be mortgaged." (Emphasis supplied.)

It is apparent that the Court did not engraft intent, *mens rea*, fraud or any other requirements upon the legislative enactments discussed. It looked only to the plain language of those statutes and did not judicially legislate. Why should Sections 155 and 156 be dealt with any differently? They should not, and neither the Referee, District Judge, nor Court of Appeals has cited any authority for treating them differently. Additionally, the only other cogent authority on the subject is further evidence to buttress the Trustee's position.

Several cases have arisen both in the State of Connecticut and in the Bankruptcy Courts where the then Connecticut Statute set out at page 5 and similar to the one at issue here was considered.

In a case arising out of a bankruptcy the United States Court of Appeals for the Second Circuit, *In Re American Metal Products Co.*, 276 F. (2d) 701, decided in 1960 had the very issue here present to determine under the above Connecticut Statute.

That Court of Appeals decided that the chattel mortgage was invalid in its entirety because of the overstatement of amount actually loaned. After finding the recorded chattel mortgage stated a sum of money to be greater than the amount actually loaned, it also found, after reviewing the Connecticut decisions "that the cases emphasize the policy objective, that the statute (enacted in 1899) was

intended to insure the veracity and reliability of the recording system."

It stated at page 704:

> "The mortgage under consideration violated the plain language and the specific policy of the statute. It operated as a constructive fraud on the recording system. The consequences is illustrated by *Whitney Frocks, Inc. v. Jaffe*, 1951, 138 Conn. 428, 85 A. (2d) 242, where the Supreme Court of Errors affirmed the trial Court's conclusion that the chattel mortgage was invalid in its entirety because only $900.00 had actually been loaned whereas the mortgage securing the loan stated the amount of the loan to be $1,200.00."

Also, at page 704, "Fraudulent motive or *mens rea* is not prerequisite to a finding of violation of the statute under consideration. It is concluded that the mortgage herein violated Section 7279 and is invalid."

And of importance on the question of whether it was valid *pro tanto* for the amount actually advanced as an equitable matter, since there were such Connecticut decisions in the field of real estate mortgages, the Court reasoned and stated at page 705:

> "The analagous legal principals with regard to real estate mortgages are judge-made. That body of law may properly be developed by the judicial applications of equitable doctrines. In the field of chattel mortgages, however, the Connecticut Legislature has spoken clearly by statute. **A Federal Court may not deflect or defeat the force of that enactment by applying an equitable doctrine where the statute does not leave room for interstitial judicial legislation.**" (Emphasis added.)

It reasoned at page 705 that:

> "One who overstates the amount of the loan in a recorded chattel mortgage would lose nothing but the amount of the overstatement, to which he frequently may not be entitled. Were the MATZ doctrine applied, for the statute to operate at all, fraud or intentional

misrepresentation would be engrafted upon the statutes as an added necessary element of proof. The recording system and its intended beneficiaries would lose the statute's protection against inept, uninformed or careless mortgages, honest though they may be. Had the Connecticut Legislature so intended, an appropriate provision would probably have been adopted in 1899 or in the many years that the statute has been operating and the subject of interpretative litigation." (Emphasis supplied.)

It might be mentioned that since the South Carolina Statute was enacted and reenacted subsequent to the Connecticut Statute and decisions, it can only be assumed that the South Carolina Legislature knows and has approved of the interpretation placed thereon.

Now, reading the Statutes at issue in the light of the cited cases, and none being cited by the Referee, District Judge, or Court of Appeals to the contrary, it would appear that the only reasonable conclusion to reach is that the South Carolina Court would literally construe the Statute and declare this chattel mortgage void; and this Court should so hold.

II. The Court of Appeals as well as the District Court and Referee have so erroneously construed and sanctioned the misconstruction of the South Carolina corporation Statutes and State common law principles applicable at the time to transactions between a corporation and its interested officers and directors, as well as having ignored this particular corporation's By-Laws, as to call for an exercise by this Honorable Court of its power of review and supervision in order to prevent inequity and injustice to Petitioner as fiduciary for unsecured creditors of the bankrupt corporation.

As heretofore stated in this Petition, the Court of Appeals originally remanded to be better advised of the meaning and effect of the pertinent South Carolina law.

The undisputed facts as stipulated and found by the Referee are that the corporate By-Laws required 84% of the outstanding stock in order to have a quorum; and that both Meyers owning one-third and Mr. Van Dolson owning two-thirds voted to authorize negotations with Mrs. Van Dolson and to give the note and chattel mortgage.

The Referee also concluded that the South Carolina case law announced the principle that a director who is disqualified by reason of personal interest, as clearly Mr. Van Dolson was, in a matter before a directors' meeting can not be counted for the purpose of making a quorum nor be counted to make up a majority vote to pass a resolution of the Board of Directors, *Peurifoy v. Loyal*, 134 S. C. 267, 151 S. E. 579; *Fidelity Fire Insurance Company v. Harby*, 156 S. C. 238, 153 S. E. 141; *Gilbert v. McLeod Infirmary*, 219 S. C. 174, 64 S. E. (2d) 524.

Clearly, and mathematically if Mr. Van Dolson were not counted because of his interest in the transaction as shown by the testimony, there would be no valid corporate action and the mortgage avoidable by the Trustee.

The Referee seemingly agreed that Mr. Van Dolson would be prohibited by the cited cases from acting for his wife, but still refused to set aside the mortgage without citing any legal authority to sustain his conclusion. He answered the question of the Appellate Court with a question.

Then the District Court in its "advice" to the Court of Appeals erroneously informed that Court that the South Carolina rule in this connection was solely a "good faith test", by misconstruing the very case he cited, as Petitioner respectfully believes. Despite the citation by the Trustee of the cases referred to by the Referee and his indication of the proper rule; and in addition thereto, despite citations of other Federal and State authorities in keeping with South Carolina precedent in similar factual instances, the

Court of Appeals stated in its opinion of June 6, 1968, ". . . the District Judge was thoroughly familiar with . . . decisional law pertinent here. No different interpretation of the laws of South Carolina by her Courts is cited to us."

The following, in addition to the South Carolina cases cited above, are the "different interpretations" which were in fact cited and which would seem to require a legal conclusion different from that rendered:

On the husband and wife feature, in *DeMoulin v. Magnesite Refactories Co.*, 186 Cal. 128, 199 P. 42, that Court stated:

> "The President, one of the two directors present and voting at the meeting, was directly interested in the passage of a resolution authorizing the execution of the mortgage to secure claim due him, which he intended subsequently to convey to his wife. His vote on the resolution, therefore, was of no avail, the resolution was without authorization, and the mortgage executed in pursuance thereof invalid".

Most illustrative of all, and extremely similar to the instant case is: *In Re Webster Loose Leaf Filing Co.*, 240 F. 779 (D. C. N. J. 1916).

The Court said, at page 782:

> "But a more serious question arises regarding the validity of this mortgage: Did a quorum of the directors qualified to act accept on January 12, 1915, the proposition submitted on behalf of Anita L. Pearson, mortgagee, and pass the resolution authorizing the execution of the mortgage for $10,000.00 to her? At the annual meeting of the stockholders, January 12, 1915, Anita L. Pearson, Gerard Roberts, and Bradford Webster were elected directors of the bankrupt company, by the stockholders. Immediately after the close of the meeting of the stockholders on said day, a directors' meeting was held at which only Gerard Roberts and Bradford Webster, two of the three directors were

present. At that meeting a proposition was submitted on behalf of Anita L. Pearson, by Gerard Roberts, one of the three directors of the company, by the terms of which she agreed to loan the company $10,000-.00 on a chattel mortgage on certain property of the corporation. This proposition was accepted by Roberts and Webster, and the following resolution passed by them."

The Court found that so far as the mortgage was concerned, Roberts was so acting for her, that the legal effect of his vote in passing the resolution which authorized the executions of the mortgage, was the same as if she herself had voted it. It then went on to discuss that legal effect. (Emphasis added.)

The authorization in question required the vote of Roberts to pass. At page 785 we find:

"All of the directors constituting a quorum must be qualified to act. If one of the directors whose presence is necessary to constitute a majority of a quorum, is disqualified by reason of his personal interest, any act done by the body is invalid. 10 Cyc. p. 777.; Cook on Corporations (7th Ed.) 713a; *Van Hook v. Somerville Mfg. Co.*, 5 N. J. Ep. 159. The rule rests upon the broad principle that it is the duty of each director in acting for the corporation to do so in the best interest of the corporation. His duty to the corporation is first. It is a duty he can not perform if his own interest is adverse to that of the corporation. So insidious are the promptings of self-interest, and so great is the danger that it will override duty, when brought into conflict with it, that sound policy requires that such contract should not be enforced or regarded. He occupies the position of a judge passing upon his own case. The proposition in behalf of Mrs. Pearson was presented at the meeting on January 12, 1915, by Gerard Roberts, her attorney, in turn voted upon the proposition submitted by himself. The court said in the case of *Van Hook v. Somerville Mfg. Co.*, that

an interested director in such a transaction, voting a mortgage to himself, must be regarded as a stranger. (Citations.)

"So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of the contract so entered into. In such cases, the court will not pause to inquire whether a director or trustee has acted fairly or unfairly; being interested in the subject-matter, he may not as a trustee or director deal with himself, and thus be subjected to the temptation to advance his own interests." (Citations.) (Emphasis supplied.)

The Court said later at p. 787:

• • •

"If the mortgage was executed in pursuance of the authority contained in the resolution of January 12, 1915, it is void as a mortgage. Mrs. Pearson herself could not vote upon a proposition in which she was interested, if her vote was necessary to pass the resolution. If she could not vote, neither could her attorney, who represented her in the board. I am constrained therefore to hold that the mortgage in question is void and of no effect. Mrs. Pearson will have to stand with general creditors."

It is interesting to note that the Court cited the case of *Curtin v. Salmon River Co.*, 130 Cal. 345, 62 P. 552. This case is also cited as authority by the South Carolina Supreme Court in *Peurifoy v. Loyal, Supra.*

In *Sundlun v. Noank Shipbuilding Co.*, 135 Conn. 108, 61A. (2d) 665, the Connecticut Court was required to apply a Rhode Island Statute which was a codification of the South Carolina rule, and reached the conclusion that the chattel mortgage was invalid against a receiver because of the participation and vote of the interested director, despite a contemporaneous loan.

It seems apparent from the foregoing authorities that the Courts below have reached a completely erroneous conclusion as to the pertinent law of South Carolina (although

the Referee did point it out) which this Honorable Court should not sanction, and which it should correct.

CONCLUSION

Petitioner respectfully submits that because the rights of his *cestuis* in this Bankruptcy matter depend as to one issue upon a matter of first impression in the interpretation of a State Statute and as to a second issue upon the correction of an erroneous conclusion by the lower Courts as to State legal precedent, he is entitled to have this Honorable Court exercise its power of supervision and review and render a final determination thereon in the establishment of precedent by granting a writ of certiorari to the Court of Appeals for the Fourth Circuit.

Respectfully submitted,

PHILIP WITTENBERG,
207 North Washington Street,
Sumter, South Carolina,
Attorney for Petitioner.

LEVI & WITTENBERG,
Sumter, South Carolina,
Of Counsel.

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REPORT OF REFEREE

JUNE 21, 1962

Wednesday, February 8, 1961, before Hon. W. C. Boyd, Referee in Bankruptcy, hearing was held at Sumter, S. C.

Appearing were:

Wendell M. Levi, Esq. and
Philip Wittenberg, Esq. — For the Trustee
M. M. Weinberg, Jr., Esq. — For the Bankrupt and for the Creditor

The purpose of this hearing was to determine whether or not a certain chattel mortgage executed by the bankrupt corporation to Ruth K. Van Dolson was in fact and in law a valid chattel mortgage, thus entitling said creditor to be a secured creditor. Also, the Trustee claims that certain payments made to Robert Van Dolson amounted to preference and restoration of the amount of such payments should be made by Mr. Van Dolson.

Testimony was taken from Robert Van Dolson, President of the bankrupt; Ruth K. Van Dolson, creditor; Arthur H. Wilder, Attorney at Law, who at one time had represented both the corporation and various stockholders; S. A. Benson, Certified Public Accountant, and E. A. Meyers, who at one time was a stockholder and employee of the bankrupt corporation.

At the conclusion of the testimony and within due time, memorandum and argument was submitted on behalf of all parties by their respective attorneys.

Seven contentions were advanced on behalf of the Trustee in Bankruptcy, as follows:

1. Contention was made that mortgage was null and void due to § 45-156 of the 1952 Code of Laws.

2. Contention was made that the chattel mortgage was executed in violation of the by-laws of said corporation.

3. That the chattel mortgage was fraudulent and therefore void under and by virtue of the provisions of Title 11, U. S. C. A., § 107 (d) (2) (a) (b) (c) (d).

4. Contention was made that the note and chattel mortgage was in violation of the Statute of Elizabeth, § 57-301 S. C. Code of Laws.

5. Contention was made that no consideration advanced for the mortgage.

6. Contention was made that only 50% consideration was advanced for the mortgage.

From the evidence, I find as a fact that the mortgage, which secures promissory note in the amount of Ten Thousand Seven Hundred Seventy-Six and 40/100 ($10,776.40) Dollars given by bankrupt to Ruth K. Van Dolson and recorded on March 23, 1960, was for a present consideration in the amount of Ten Thousand ($10,000.00) Dollars, paid in cash by Mrs. Van Dolson to the bankrupt corporation, and which amount was disbursed to creditors of the corporation, is a valid obligation to the extent of Ten Thousand ($10,000.00) Dollars and that the bankrupt corporation is indebted to Ruth K. Van Dolson in the sum of Ten Thousand ($10,000.00) Dollars, together with the unpaid interest thereon, and she is entitled to proceed as a secured creditor.

From the evidence, it appears that within four (4) months prior to the filing of the involuntary petition of August 4, 1960, Mr. Robert Van Dolson reimbursed himself in the amount of Five Hundred ($500.00) Dollars for an advance to the corporation. On May 6 he repaid himself an advancement of Thirty-Three ($33.00) Dollars; on May 21 he reimbursed himself for an advancement in the sum of Three Hundred ($300.00) Dollars, all together totaling Eight Hundred Thirty-Three ($833.00) Dollars. At the time these advancements were made, the corporation was insolvent and Mr. Van Dolson knew or should have known of this condition. Such repayments to him amounted to an unlawful preference under the Bankruptcy Act and he should be required to restore to the Trustee the sum of Eight Hundred Thirty-Three ($833.00) Dollars, and it is so ORDERED.

Mr. Van Dolson also reimbursed hirself from the bankrupt corporation the sum of Six Hundred Seventy-Six and 40/100 ($676.40) Dollars which amount had been advanced to the corporation. This amounted to an unlawful preference under the Bankruptcy Act and Mr. Van Dolson

should restore to the Trustee that amount and it is so ORDERED.

/s/ W. C. BOYD,
Referee in Bankruptcy.

Columbia, South Carolina,
June 21, 1962.

UNITED STATES DISTRICT COURT, D. SOUTH CAROLINA COLUMBIA DIVISION

JULY 6, 1965

Before this Court are cross-Petitions for Review of the Order of the Referee in Bankruptcy dated June 21, 1962. Arguments of counsel fully explored, in the open court hearing of June 22, 1965, all the facets of contentions between the parties. Thereafter the court took the matter under advisement, reviewed a transcript of certain testimony taken before the Special Referee at Sumter, S. C. February 8, 1961, and examined the entire file and exhibits.

The Referee in Bankruptcy had ample evidence before him to support his findings and Order. Indeed, if credibility be an issue, he was in best position to pass thereon, as the testimony was given before him.

The Petitions for Review are denied and the Order of the Referee affirmed as to all findings.

AND IT IS SO ORDESED.

/s/ ROBERT W. HEMPHILL,
United States District Judge.

Columbia, South Carolina,
July 6, 1965.

The Court, once the matter was called to its attention, repeatedly afforded opportunities for a hearing.

A TRUE COPY. ATTEST.
/s/ HELEN BREELAND,
Clerk of U. S. District Court,
East. Dist. So. Carolina.

OPINION OF THE COURT OF APPEALS
MAY 2, 1966

PER CURIAM:

The District Court's order in bankruptcy approving a report of the Referee is now brought here on appeal by the trustee. Because there is no statement, either in the report or the order, of the conclusions of law underlying the decisions, we cannot review them with certainty. Therefore we must vacate the order and remand the cause for correction of this deficiency in the record.

Chiefly, the controversy involves the validity of a chattel mortgage executed by the bankrupt, a corporation chartered and doing business in South Carolina, to secure the payment of its note of $10,676.40, which was given to the appellee for moneys advanced by her to the corporation. She was the wife of a director and officer, and was herself a director and officer. The trustee attacked the chattel mortgage on two grounds. The first was that the mortgage was void by virtue of sections 45-155 and 156, Code of Laws of South Carolina, 1952, declaring unlawful and invalid any mortgage in which the amount of the indebtedness therein stated to be secured is in excess of the sum actually received by the borrower. The second point was that the instrument was void because it was not executed and delivered either according to the corporate by-laws, as required by section 12-102(4) of the Code, or common-law principles governing transactions between corporations and interested officers and directors.

Other claims of the trustee on this appeal are for the recovery of interest paid by the corporation to the appellee-mortgagee on the note and also of amounts drawn as salary by the dominant stockholder and director. The fact that the latter items were not *mentioned* by the Referee is but another example of the inadequacy of the record.

While a large part of the facts surrounding the execution of the note and mortgage were stipulated before the Referee, many determinative circumstances were not included. The Referee made no detailed findings of fact in respect to the note, mortgage or interest paid. He was content to say that while the mortgage put the amount secured

at $10,776.40, only $10,000.00 had been advanced by the lender. However, the obligations were held valid because they were "for a present consideration in the amount of Ten Thousand ($10,000.00) Dollars, paid in cash by . . . [the lender] to the bankrupt corporation, and which amount was disbursed to creditors of the corporation. . . ."

Nowhere does the Referee give his reasons for holding the two documents to have been duly authorized under the corporate by-laws and the State statute. Nor does he state his conclusions of law upon the effect of the statutes annulling a mortgage which secures an amount in excess of the sums actually loaned upon it. Consequently, we are left to guess on these critical features.

As the assault upon the mortgage is mounted on State laws with which the Referee and the District Judge have far more familiarity than do we, their interpretations of these enactments and their conclusions of law upon the transaction are highly important on appeal.

The Bankruptcy Act provides for a review of a Referee's order by the District Judge on a certificate by the Referee of the proceedings. §§ 2a(10), 29a(8), and 39c, 11 U.S.C. 11a(10), 67a(8) and 67c. General Order 47 of the Supreme Court, 11 U. S. C. foll. 53, prescribes what the Referee shall include in his certificate and how the judge acts upon it, as follows:

> "Unless otherwise directed in the order of reference the report of a referee or of a special master shall set forth his findings of fact and *conclusions of law*, and the judge shall accept his findings of fact unless clearly erroneous. The judge after hearing may adopt the report or may modify it or may reject it in whole or in part or may receive further evidence or may recommit it with instructions." (Accent added.)

This provision applies to all orders of a Referee brought to the District Court for review. *Rosehedge Corp. v. Sterrett*, 274 F. (2d) 786 (9 Cir. 1960).

As the General Order has not been followed by the Referee and as we do not have the District Judge's reasons for accepting the Referee's reading and application of the

State law, we set aside the order on appeal and remand the cause to the District Court for recommitment to the Referee. In no way do we intimate any invalidity in the note or mortgage; we seek only to be better advised of the meaning and effect of the pertinent South Carolina law.

As the parties to the appeal are not responsible for the faulty record, the costs here will be taxed against the appellant with reimbursement out of the assets of the bankrupt estate.

ORDER OF REFEREE

JUNE 28, 1967

An Order approved by the District Court was vacated on appeal to the Circuit Court of Appeals for the Fourth Circuit and recommitted to me in order that I should set forth more complete findings of fact and conclusions of law with reasons therefor. *Faucette, Trustee v. Van Dolson,* 360 F. (2d) 611, dated May 2, 1966.

FACTS

On October 28, 1959, Lighting Center, Inc., was incorporated under the laws of the State of South Carolina. Sixty (60) shares of $100.00 par value stock were authorized, and thirty (30) shares were issued, ten (10) shares each to J. W. Harper, President, and Edward Meyers, Treasurer, and five (5) shares to Fannie L. Harper, Vice-President, and E. B. Johnson, Secretary. The corporation commenced business in November, 1959, with Meyers as General Manager.

On or about March 1, 1960, differences arose between the principals in the corporation, Meyers discussed the business with Robert Van Dolson, who operated a pet shop next door. As a result of this discussion, Van Dolson agreed to and did purchase the interest of the Harpers and Johnson. The purchase was consumated during the evening of March 5, 1960, and Van Dolson acquired the twenty (20) shares of stock for the total sum of $2,676.40.

Some time prior to the transaction mentioned, Van Dolson and his wife, Ruth K. Van Dolson, sold real estate which they jointly owned for some $50,000.00, and the proceeds were deposited in joint savings and checking accounts

entitled "Robert Van Dolson or Mrs. Ruth Van Dolson." Van Dolson drew his check on the joint checking account for $2,676.40 in payment of stock purchased by him. After the purchase of the Harpers' and Johnson's interest by Van Dolson a meeting of the stockholders was held which was attended by Mr. Clifton, who apparently acted as attorney for Van Dolson, and Meyers, the sole stockholders. Meyers and Van Dolson were named to the Board of Directors, the Harpers and Johnson having resigned. Meyers was named President and General Manager and Van Dolson, Secretary and Treasurer, and Mrs. Van Dolson, Vice-President. The bylaws provide that each officer is a member of the Board of Directors. From the testimony before me, it is obvious that neither Van Dolson nor Mrs. Van Dolson knew anything about the lighting business and relied mainly on information given to them by Meyers. At the time of the acquisition by Van Dolson of an interest in the bankrupt corporation it was thought that $10,000.00 in fresh money would enable the corporation to pay off pressing creditors and continue a profitable business.

At the directors and stockholders meeting held on May 5, 1960, it was decided that a loan of $10,000.00 should be made by the corporation from Ruth Van Dolson, and this loan was actually consummated on March 22, 1960, all documents including note and chattel mortgage being prepared by Mr. Clifton, attorney for the bankrupt. The note and chattel mortgage to Ruth K. Van Dolson to secure the $10,000.00 loan was actually given in the amount $10,676.40. (It is my opinion from the testimony and after hearing the witnesses that Mrs. Van Dolson was not fully cognizant of what was going on and that the note should have been $10,000.00 instead of $10,676.40, which amounted to a scrivener's error.) At no time has an attempt been made by her to collect more than $10,000.00. At the time the chattel mortgage was given to secure the note in question, which chattel mortgage covered the inventory, the inventory was valued at $17,526.58 which was subsequently found to be an overvaluation.

The bylaws of the corporation provide that 84% of the outstanding stock shall constitute a quorum at all meetings

of stockholders and that a majority of the quorum, whether stockholders or directors, may decide any question coming before the meeting. The vote of the directors and/or the stockholders, Meyers ten (10) shares, Van Dolson twenty (20) shares, to borrow the money from Mrs. Van Dolson and to give the corporation note and chattel mortgage is attacked by the Trustee on the grounds that Van Dolson, having an interest in the note and chattel mortgage, was barred from participating, and his vote should not be counted. This will be hereinafter discussed.

Within four months prior to the filing of the involuntary petition for bankruptcy, Van Dolson reimbursed himself in the amount $500.00 for an advancement to the corporation, for an advancement of $33.00 and an advancement of $300.00 or a total of $833.00. He also reimbursed himself from the funds of the corporation the sum of $676.40.

Van Dolson likewise paid to himself as salary from April 23, 1960, to date the petition was filed the sum of $125.00 per week making a total of $1,375.00. He did not withhold income or FICA taxes from his salary, but agreed to reimburse the Trustee for appropriate sums due therefor.

As stated, there is no question but that the $10,000.00 loaned by Mrs. Van Dolson to the corporation was immediately disbursed to creditors of the corporation, thereby reducing the liabilities of the corporation.

The trustee seeks the following:

1. To set aside the mortgage lien by declaring the chattel mortgage given to Mrs. Van Dolson null and void for the following reasons:

(1) That it violates § 45-156 of the 1952 South Carolina Code.

(2) That the note and chattel mortgage were executed in violation of the bylaws of the corporation.

(3) That the chattel mortgage was fraudulent and therefore void under the provisions of Title 11, U. S. C. A., § 107 (d) (2) (a) (b) (c) (d).

(4) That the note and chattel mortgage violated the Statute of Elizabeth, § 57-301 South Carolina Code of Laws.

(5) That there was no consideration advanced for the mortgage.

(6) That at any rate only 50% consideration was advanced for the mortgage.

CONCLUSIONS OF LAW

Section 45-155 South Carolina Code provides that it shall be unlawful to take a mortgage for a greater amount than actually lent, and § 45-156 provides that all mortgages given as security for loans which on its face shall show an indebtedness greater than the amount actually received by the borrower in violation of § 45-155 are null and void and of no effect. If these statutes be construed literally, then Mrs. Van Dolson does not have a secured claim. The Referee has made an exhaustive search of the South Carolina law, and the sections mentioned have never been construed by our Supreme Court. As a matter of fact, similar statutes have been before the state courts of last resort on few occasions. A similar statute in the State of Connecticut has been construed by the Supreme Court of that state in *Whitney Frocks, Inc. v. Jaffe*, 1951, 138 Conn. 428, 85 A. (2d) 242, followed by the Court of Appeals for the Second Circuit, *In Re American Metal Products Co.*, 276 F. (2d) 701.

It is the Referee's opinion, that if a chattel mortgage is intentionally given by mortgagor and received by mortgagee for an amount greater than was actually received, that under the applicable statutes of South Carolina it is null and void. However, it is the opinion of the Referee that under the circumstances in which this mortgage was given, due to carelessness so often present among inexperienced businessmen, that there was no intent to give nor receive a mortgage in excess of the $10,000.00 actually loaned, and it amounted to a scrivener's error. I do not believe that Mrs. Van Dolson should be penalized for something over which she had no control. As is so often the case, a husband handles his wife's money as if it were his own resulting in just such situations as we have here.

The sections of the South Carolina Code complained of are drastic and punitive, and I am of the opinion that

our Supreme Court would hold that there must be an intent to violate them before a security instrument contrary to their terms will be held null and void. In the *American Metal Products Co.* case, 276 F. (2d) 701, there was dealing between two experienced, competent business concerns, and there is no question but that intent to do what was done was present.

Was the chattel mortgage null and void because it was executed pursuant to resolution of the sole stockholders of the corporation, Meyers and Van Dolson, because the latter was the husband of mortgagee? Admittedly, the transaction is suspect, but the fact remains that the $10,000.00, which unquestionably was the money of Mrs. Van Dolson, went into the corporation and was used by the corporation to pay debts of the corporation. Under the South Carolina law a wife is a femme sole.

The South Carolina cases cited by the Trustee announce the principle that a director who is qualified by reason of personal interest in a matter before a directors' meeting cannot be counted for the purpose of making out a quorum nor be counted to make up a majority vote to pass a resolution of the Board of Directors, *Peurifoy v. Loyal,* 134 S. C. 267, 151 S. E. 579; *Fidelity Fire Insurance Company v. Harby,* 156 S. C. 238, 153 S. E. 141; *Gilbert v. McLeod Infirmary,* 219 S. C. 174, 64 S. E. (2d) 524.

Is Mrs. Van Dolson to be penalized by the act of her husband in acting as a director of the corporation because he would be prohibited from so acting as an interested party for her contrary to the law of South Carolina above mentioned? As is some time the case as all practitioners have experienced, a wife can be wrecked by the acts of a husband who is a principal in a small unsuccessful corporation.

Based upon the above findings of fact and law, it is the Referee's opinion that Mrs. Van Dolson is entitled to a secured claim under her chattel mortgage in the amount $10,000.00 with interest thereon provided. As a matter of fact, there is no chance of her collecting the $10,000.00 as the inventory of her corporation was appraised at $8,000.00

after the adjudication in bankruptcy, and it is doubtful that it was worth that much.

It is further the opinion of the Referee that the giving of this mortgage was not in violation of 11 U. S. C. A. 107 and § 57-301, 1952 South Carolina Code of Laws.

In so far as the advancements of Van Dolson for which he reimbursed himself in the aggregate amount of $883.00 and $676.40, it is clear that these reimbursements amounted to a preference under the Bankruptcy Act and further elaboration is not deemed necessary and as held in my original Order, should be restored to the Trustee. It further appears, which was not covered in my original Order, that the salary drawn by Van Dolson for a period of eleven weeks commencing on April 23, 1960, at the rate of $125.00 per week or a total of $1,375.00 was excessive for the reason that he was the principal owner and was obviously interested in salvaging a sinking vessel, which by the time he commenced to draw this compensation he knew to be hopelessly insolvent, and that he should restore the money so drawn to the Trustee.

Based on my findings of fact and conclusions of law, it is:

ORDERED

1. That the chattel mortgage of Mrs. Ruth K. Van Dolson securing promissory note in the amount $10,676.00 is a valid obligation to the extent of $10,000.00 together with unpaid interest thereon.

2. That the funds which Van Dolson reimbursed himself from the till of the bankrupt corporation for advancements in the total amount $883.00 and 676.40 are unlawful preferences under the Bankruptcy Act, and the same shall be restored to the Trustee.

3. That the salary which Van Dolson paid to himself from the till of the bankrupt corporation in the total amount $1,375.00 amounts to an unlawful preference under the Bankruptcy Act, and such amount shall be restored to the Trustee.

W. C. BOYD,
Referee in Bankruptcy.

Columbia, South Carolina,
June 28, 1967.

UNITED STATES DISTRICT COURT, D. SOUTH CAROLINA, COLUMBIA DIVISION

DECEMBER 18, 1967

This court reviews, on application of the Trustee, the recapitulation of the Referee in Bankruptcy. He was directed to follow General Order 47 of the Supreme Court,[1] that he has made appropriate response. A rereading of the 11 U. S. C. foll. 53 by command of the United States Court of Appeals, Fourth Circuit.[2] It is the opinion of this court record convinces this court that the findings and conclusions of the Special Referee should be affirmed by this court. It should be "kept in mind" that the Referee, experienced as a lawyer and long in tenure as Referee, had before him the witnesses and was in the best position to determine the credibility of the testimony. It is significant that the record is absent any evidence or suspicion, of fraud.

Chiefly, the controversy involves the validity of a chattel mortgage executed by the bankrupt, a corporation chartered and doing business in South Carolina; to secure the payment of its note of $10, 676.40, which was given to the appellee for moneys advanced by her to the corporation. She was the wife of a director and officer, and was herself a director and officer. The trustees attacked the chattel mortgage on two grounds. The first was that the mortgage was void by virtue of sections 45-155 and 45-156, Code of Laws of South Carolina, 1952, declaring unlawful and invalid any mortgage in which the amount of the indebtedness therein stated to be secured is in excess of the sum actually received by the borrower. The second point was that the instrument was void because it was not executed and delivered either according to the corporate by-laws, as required by section 12-102(4) of the Code, or common-

[1] Unless otherwise directed in the order of reference the report of referee or of a special master shall set forth his findings of fact and *conclusions of law*, and the judge shall accept his findings of fact unless clearly erroneous. The judge after hearing may add report or may modify it or may reject it in whole or in part or receive further evidence or may recommit it with instructions. (Accent added.)

[2] 360 F. (2d) 611.

law principles governing transactions between corporations and interested officers and directors.

360 F. (2d) 611, 612.

It is uncontradicted that the mortgage was given as security to Mrs. Van Dolson for Ten Thousand ($10,000.00) dollars which was received by the corporation from her and disbursed to its creditors.

The transcript of record shows that all papers were prepared by W. L. Clifton, Esquire, who was acting as attorney for Mrs. Van Dolson, for the corporation, and for the Harpers and one (Johnson) who sold their stock to Mr. Van Dolson. The mortgage was prepared by him and signed by Mr. Van Dolson on behalf of the corporation. Mr. Van Dolson's testimony is without contradiction that he never knew that the corporation obligated itself to pay more than the Ten Thousand ($10,000.00) dollars until the date of the first hearing at which time he was shown this mortgage.

The testimony is completely uncontradicted to the effect that Mrs. Van Dolson has never at any time made claim for any amount in excess of the Ten Thousand ($10,000.00) dollars actually advanced by her. The cases cited in the brief of the trustee, both now before this court and in the Circuit Court are cases in which fraud was an element. It is obvious from a close reading of the record here that there was no attempt to defraud the creditors. On the contrary, the Ten Thousand ($10,000.00) dollars advanced by Mrs. Van Dolson to the corporation went to pay off Ten Thousand ($10,000.00) dollars worth of creditors. There is no showing that either Mr. or Mrs. Van Dolson or anyone in any way connected with them received any part of the Ten Thousand ($10,000.00) dollars and in fact all of the Referee's findings have been to the contrary. These findings are fully substantiated by the testimony.

The Referee has found that this wife advanced her Ten Thousand ($10,000.00) dollars in good faith. She withdrew her savings. She took a mortgage therefor which was, by mistake, drawn in the amount of Ten Thousand Six Hundred Seventy-Six and 40/100 ($10,676.40) dollars. The mistake was made by the scrivener who was the attorney for all parties concerned. The mistake was unknown to either

party until the advent of this hearing. There has been no claim at any time for any amount in excess of the Ten Thousand ($10,000.00) dollars actually loaned. All of the moneys so received were paid to *bona fide* creditors of the corporation. No showing has been advanced that the innocent mistake of the parties hereto has caused or brought about detriment to any person.

The second contention before the court is that the mortgage was executed in violation of the by-laws of the corporation and that a quorum was not present. Factually, the situation is that all of the holders of stock met in the back room of the store and agreed to the mortgage in question. Their common attorney was present and drew the mortgage the following day or shortly thereafter.

The trustee insists that Mr. Van Dolson "was interested" and that this interest would disqualify him from constituting a part of a quorum. In response to a question under rigorous and severe cross examination, Mr. Van Dolson admitted he "was interested." However, it is obvious that the interest professed by Mr. Van Dolson was not sufficient to bring this case under the cases relied upon by the trustee. It further appears he was interested in paying the money to the creditors. He received, in reality, no benefit from the money. It is apparent his hands are clean.

This statute has been construed within the jurisdiction of this court in the case of *Gilbert v. McLeod Infirmary*, cited at 64 S. E. (2d) 524, and the law set out therein plainly is based upon good faith between the parties and states that where the transaction was openly and fairly made and for adequate consideration, it will be sustained:

> The test just cited, revised Vol. 3, 1947, of Fletcher, beginning at page 329, sec. 913 *et seq.*, contains excellent exposition of the law relating to personal dealings of an officer or director with his corporation or its property, with copious citations of decided cases in the footnotes. From the extensive review of the authorities there is extracted the rule that when a director, in selling corporate property to himself, represents or joins in the representation of the corporation, the transaction is voidable at the option of the

corporation, or others suing in its behalf, merely upon proof of the fact stated; but when the purchasing director abstains from participation in behalf of the corporation and it is properly represented by others who are personally disinterested, the transaction will stand under attack if the director made full disclosure, paid full value, and the corporation has not been imposed upon; and the burden is upon the director to establish these requisites by evidence. Later herein the facts of the instant case will be tested by this rule, which we consider sound and correct. The respondents accede, in effect, to it; the following, from 3 Pom. Eq. Jur., 3rd Ed. 283 *et seq.*, appears in their brief: "In the case of corporations, which can only act through agents, there is often some difficulty in determining which of these two rules is applicable to a given transaction; *viz.*, in solving the question of fact, whether the director or officer was acting in the transaction as agent or representative of the corporation, as well as on his own behalf, in which case the second rule should apply, and the transaction should be absolutely voidable; or whether the corporation was effectively represented in the transaction by other agents, so that it may be said to have taken part therein 'knowingly', and thus the director or officer has merely the burden of proving the fairness and good faith of his contract."

Mr. Van Dolson has satisfied the Special Referee and this court of his fairness and good faith in the matter. So has his wife.

The Report of the Special Referee is affirmed.

AND IT IS SO ORDERED.

ROBERT W. HEMPHILL,
United States District Judge.

Rock Hill, South Carolina,
December 18, 1967

TRUE COPY.

Test:
MILLER C. FOSTER, JR.,
RALPH D. PRIESTER,
By: Deputy Clerk.

OPINION OF THE COURT OF APPEALS

JUNE 6, 1968

PER CURIAM:

After our decision of May 2, 1966, *Faucette, Trustee v. Van Dolson*, 360 F. (2d) 611, the District Court sent this cause to the Referee in Bankruptcy again. The inquiry directed was on the validity of the note and chattel mortgage in the sum of $10,676.40 given March 22, 1960, to Ruth K. Van Dolson for her loan of $10,000, by the bankrupt, Lighting Center, Inc., a South Carolina corporation conducting an electrical supply business in Sumter.

As noted in our first opinion, *supra*, the trustee in bankruptcy had questioned the lien. His position, first, was that since concededly the mortgagee had loaned the corporation only $10,000, the South Carolina statute [3] rendering a mortgage voidable for overstatement of the amount of the loan, nullified it. Secondly, his position rested on the absence of the requisite board authorization [4] for a corporate mortgage when a member is personally interested in the transaction, Ruth K. Van Dolson being the wife of a director. The District Court sought the fact findings and legal conclusions of the Referee upon the issue.

His subsequent report was, in substance, that the note and mortgage had been executed and delivered by the corporation with full knowledge and assent of all the stockholders and directors, that these papers represented a *bona fide* obligation, that the corporation had received from Ruth K. Van Dolson in cash a loan of $10,000, that there was no suggestion of fraud or overreaching, that she had never claimed more than $10,000 as owing to her, and that the statement in the mortgage of $10,676.40, instead of $10,000, as the amount of the loan was attributable to an innocent mistake, not chargeable to the mortgagee. On these facts the Referee concluded that the chattel mortgage was a valid and subsisting lien. These findings and conclusions were completely accepted by the District Judge. The trustee appeals.

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[3] Code of Laws of South Carolina, §§ 45-155, 156 (1952).

[4] *Id.*, § 12-102(4) (1952).

The facts just recited have generous support in the evidence, and the District Judge was thoroughly familiar with the State statutes and decisional law pertinent here. No different interpretations of the laws of South Carolina by her courts is cited to us. We have no reason to disturb the determination of the Referee and Judge.

Affirmed.

LIBRARY
SUPREME COURT, U. S.

FILED
OCT 7 1968
JOHN F. DAVIS, CLERK

Supreme Court of the United States

October Term, 1968

No. 465

IN THE MATTER OF:
LIGHTING CENTER, INC., BANKRUPT

IN RE:
A. M. FAUCETTE, JR., TRUSTEE IN BANKRUPTCY,
PETITIONER,

versus

MRS. RUTH K. VAN DOLSON, RESPONDENT

REPLY OF RESPONDENT TO PETITIONER'S PETITION FOR A WRIT OF CERTIORARI

M. M. WEINBERG, JR.,
111 N. Main Street,
Sumter, South Carolina.

WEINBERG & WEINBERG,
Sumter, South Carolina,
Attorneys for Lighting Center,
Inc., Bankrupt.

The R. L. Bryan Company, Legal Printers, Columbia, S. C.

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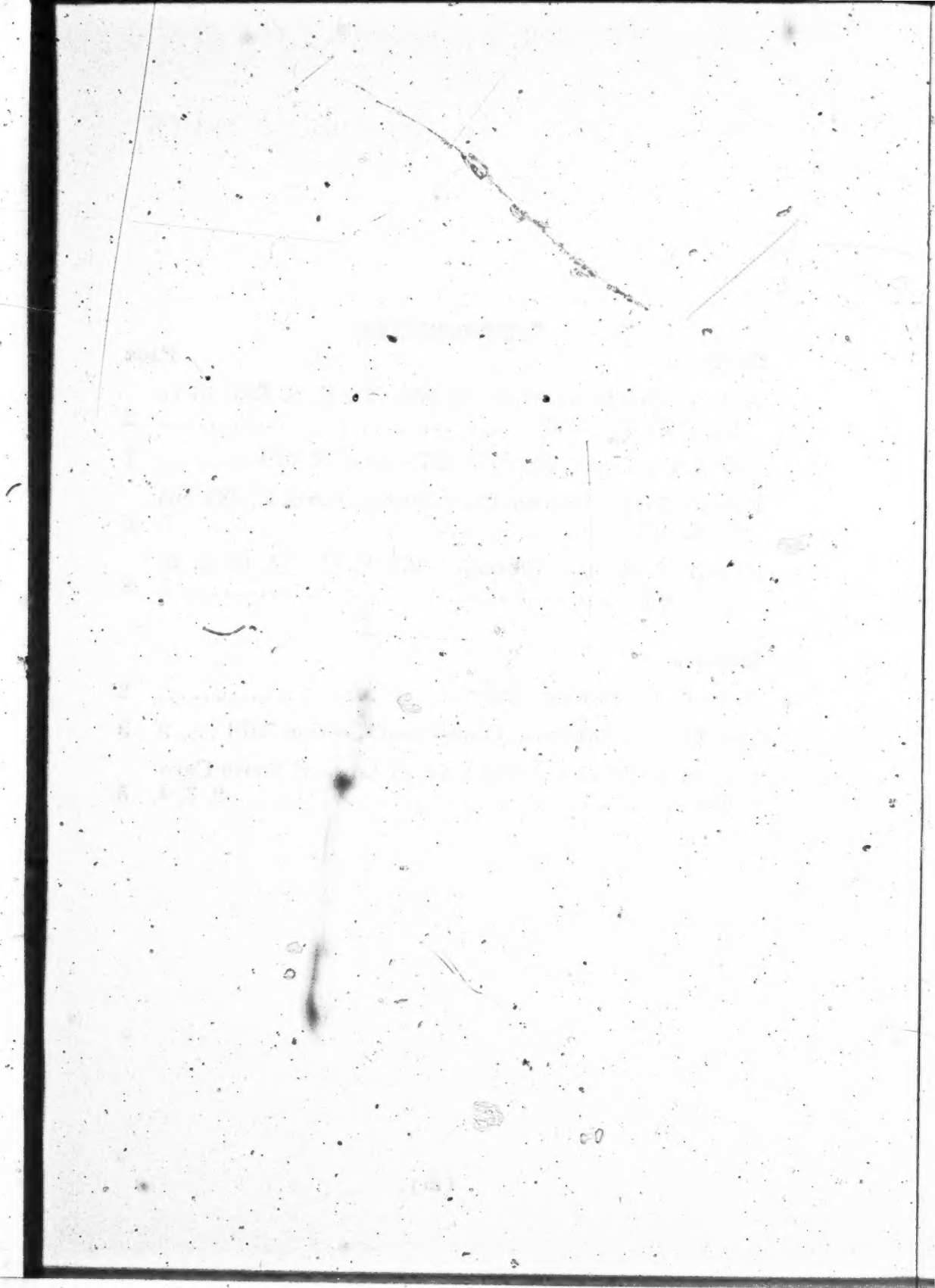

Supreme Court of the United States

October Term, 1968

No. 465

IN THE MATTER OF:

LIGHTING CENTER, INC., BANKRUPT

IN RE:

A. M. FAUCETTE, JR., TRUSTEE IN BANKRUPTCY,
PETITIONER,

versus

MRS. RUTH K. VAN DOLSON, RESPONDENT

REPLY OF RESPONDENT TO PETITIONER'S PETITION FOR A WRIT OF CERTIORARI

The Respondent hereby petitions this Honorable Court to deny a writ of certiorari to review the decision of the United States Court of Appeals for the Fourth Circuit entered June 6, 1968.

JURISDICTION

Appellee respectfully contends that the position of Appellant as to the jurisdiction of this Court in the instant matter is without merit.

Appellant asserts that a conflict of decision exists between the Second and fourth Circuit Courts of Appeal in the construction of allegedly similar State Statutes, Section 45-155 of the 1952 Code of Laws of South Carolina and 1949 Rev. S. Conn. 7279.

The most cursory reading of these two statutes shows that they are, in fact, entirely dissimilar and that, therefore, no conflict can exist in their construction.

It is further respectfully contended that in the absence of a conflict in Circuit Court opinions, Rule 19 of the Rules of the Supreme Court of the United States and Title 28, Section 1254 U.S. Code Annoted, as construed by the case of *Wolf v. Weinstein*, 83 S. Ct. 969, 372 U. S. 633, 10 L. Ed. (2d) 33 (1963) do not provide for the consideration of the instant matter by this Court but that the answer to the jurisdictional question involved was stated by this court at page 636:

> "... the controversy ... primarily implicates questions of Pennsylvania Law and presents no Federal question of substance. In the circumstances, the writ of certiorari ... is dismissed as improvidently granted."

QUESTIONS PRESENTED

Respondent adopts petitioner's questions as printed.

APPELLEE'S ADDITIONAL STATEMENT OF THE CASE

Appellee contends that Appellant's statement of fact contains the following inaccuracies, to wit:

1. As to the statement of the insolvency of the corporation at the time of the purchase of the stock, Appellant submits that there is no testimony in the record showing the Van Dolson's knowledge of the pending insolvency of the corporation.

2. That contrary to Appellant's statement, Mrs. Van Dolson, the Appellee, was not present at the corporate meeting as alleged therein. Appellant's brief before the Circuit Court of Appeals has set this out at Tr. 28-33, affirmatively showing that Mrs. Van Dolson was in fact not present.

3. As to Appellant's contention that Mr. Van Dolson was acting for the corporation in addition to representing his wife's interest, there is no testimony to affirmatively substantiate this fact and, in reality, the testimony affirmatively shows the contrary to be the case.

4. Appellant sets out various appraisal prices. However, the stipulated facts below conclusively show that these assets were purchased for $8,000.00 which was the highest obtainable bid regardless of the appraised prices.

ARGUMENT

Question I

Appellant seeks construction of Section 45-155 of the 1952 Code of Laws of South Carolina by this Court. In aid of his contention he quotes 1949 Rev. S. Conn. 7279, a Conn. Statute which has been heretofore construed in a Circuit Court of Appeals:

> "Any person who shall loan money upon a note secured by a mortgage upon personal property, in which the sum of money loaned is stated to be greater than the amount actually loaned, or in which the rate of interest to be charged is greater than the rate allowed by law to be charged by pawnbrokers, shall be fined not more than fifty dollars or imprisoned not more than three months or both; and the mortgage and note secured thereby shall be void." (emphasis added)

On the other hand, Sec. 45-155, **Code of Laws of South Carolina** (1952) "Unlawful to take mortgage for greater amount than actually lent."

> **"It shall be unlawful for any such lender of money, his agents, employees, or any person in his behalf, to have inserted in his mortgage,** or bill of sale, as representing the indebtedness of the mortgagor or vendor, an amount in excess of the actual amount of money received by the borrower, except as provided for in Sec. 45-153 and Sec. 45-154 and recording fees." (emphasis added)

Without question these statutes vary. The Connecticut Statute is self operative by its very language, as are most criminal statutes.

The South Carolina Statute, however, is entirely different. It is a civil statute invoking, when all conditions therein are met, a forfeiture.

Before the Statute becomes operative, he who seeks to invoke it necessarily must affirmatively prove:

(1) That the mortgage was prepared by the lender or its agents;
(2) That the overstatement in this mortgage was made by lender or its agents;
(3) That said overstatement was purposely inserted by lender.

The record is completely void of any proof or even an attempt to prove that the lender caused the overstatement to be inserted in the mortgage now before this Court.

The evidence conclusively shows the contrary.

The scrivener of the instrument in question was the attorney for the corporation, the borrower, and for the individual corporate stockholders.

The existence of the overstatement is not alleged to have been either known to the lender or caused by her.

Robert Van Dolson testified that he had no knowledge that the mortgage was an amount greater than $10,000.00. He even testified further that he had considered the $676.40 in question to have been a separate loan made by him entirely outside of the mortgage in question and from his funds.

Reference is made to the Order of Referee dated June 21, 1962. There, the last paragraph orders Mr. Van Dolson to restore this amount to the trustee as an unlawful preference. This portion of the order has not been appealed.

It would therefore seem that the fact of the intentions of all concerned are well corroborated.

It is obvious that the affirmative proof required to invoke the desired forfeiture is fatally deficient.

While Appellant contends that construction of related statutes are persuasive toward his view, it should be noted that no statute relied upon by the appellant requires an affirmative act on the part of the lender as does Sec. 45-155 of the 1952 Code of Laws of the State of South Carolina.

Appellant relies upon a lack of judicial decisions requiring *mens rea* on the lender's part. Unfortunately, no precedent has been advanced construing a statute which, by its very language, requires an affirmative act on the part of the lender as does the statute upon which the appellant now relies.

The bulk of appellant's argument concerns itself with an affirmative stand that there was no testimony that the overstatement was the scrivener's error of the corporation's attorney. A most casual review of the testimony shows ample basis for this finding of fact by the Referee. It must appear that a contrary finding is impossible.

Appellant further contends that the terms of the mortgage are always construed strictly against the mortgagee. This is obviously incorrect as it is a fundamental rule of construction that the terms of an ambiguous instru-

ment, everything else being equal, will be construed against the party who prepared the instrument.

The evidence is overwhelming that this instrument was prepared by Mr. Clifton, the attorney for the corporation, the borrower, and for each of the individual stockholders.

The balance of appellant's argument confines itself to matters in which there is a conflict of testimony.

The conflicts have been resolved in favor of the defendant in this matter by the Hearing Officer who alone has had the opportunity to observe the demeanor and conduct of the witnesses and assess the probative value of their testimony. No sound reason has been advanced to reverse the Referee on his finding of fact. Nor has valid legal precedent to make the desired forfeiture been shown.

It is therefore submitted that the order appealed from is correct and should be affirmed by this Court.

Question II

Here the appellant apparently seeks a reversal of the Referee's finding of fact in spite of said finding having been many times affirmed.

The sole dispute raised here is factual in nature. Was Van Dolson an "interested director"?

In order to properly resolve this question, it must be kept in mind that any interest alleged by the appellant must be affirmatively proven by this appellant to be an interest adverse to the best interests of the corporation and an interest which works to the detriment of said corporation.

Appellant's claims of interest are founded solely upon his cross examination of Mr. Van Dolson wherein he asked him if he was interested in securing money loaned by his wife. Under the cases cited, this would hardly amount to an adverse interest sufficient to set aside security for money actually advanced and paid out to the corporate creditors.

It would be more aptly characterized as a clever play on words by a learned cross examiner in an attack upon an honest but uninformed layman.

The South Carolina cases cited by appellant in support of this contention are factually extremely dissimilar to the instant case.

In each of them the director in question was himself the interested party; his interest was never imputed to another.

Each case depends upon the factual finding that the director was proven to have a personal, active, and adverse interest of his own.

In summary, the interest of the corporation, which received $10,000.00, was much better protected than the interest of the lender who only recovered $8,000.00. Apparently, the Appellant contends that the corporation was in some manner prejudiced, but has shown no detriment to the corporate interests. To the contrary, the creditors of the corporation have profited by the transaction at the lender's expense in the amount of $2,000.00.

It is therefore easily seen that Mr. Van Dolson's interest was not the interest required to bring this case within the authorities cited.

Peurifoy v. Loyal, 134 S. C. 267, 151 S. E. 579;
Fidelity Fire Insurance Co. v. Harby, 156 S. C. 238, 153 S. E. 141;
Gilbert v. McLeod Infirmary, 219 S. C. 174, 64 S. E. (2d) 524.

In each of these cases the necessary adverse interest was found as a fact based upon the following circumstances: In the *Peurifoy* case the interested director in question had actually stolen certain bonds of the bank of which he was president and pledged them elsewhere as collateral on his own account. Subsequently, he, together

with an accomplice, voted at a board of directors meeting to approve this act, attempting to ratify an obviously illegal act, the taking of the property of the corporation and converting it to his own use without consideration.

In the *Fidelity Fire Insurance Co. v. Harby* case the interested director who was necessary to make a quorum for a vote on corporate purchase of land was in fact the real estate broker who claimed a commission from the party who sold the land to the corporation as well as from the corporation for "services rendered."

In the *Gilbert v. McLeod Infirmary* case the facts show, and the court so held, that the interested directors were the purchasers of land owned by the corporation; that the consideration for the purchase was inadequate and that the purchase was attempted to be effected in unseemly haste and with the exercise of undue influence by the director.

In the case before this court, the transcript yields the following facts:

(1) Mrs. Van Dolson, the lender, was not present at the meeting in question.

(2) The ten thousand ($10,000.00) dollars was paid to the corporation and immediately disbursed to *bona fide* creditors.

(3) The security given to the lender by the corporation was inadequate, ultimately bringing at sale to the highest bidder 20% less than the amount of money loaned. (Stipulated facts.)

It is quite obvious that no parallel can be drawn between the facts of the instant case and the above cited cases. In each of the cited cases the director was either attempting to, or did, convert the funds or property of the corporation to his own use, either illegally or immorally, while in the instant case the director in question obviously protected the interests of the corporation far better than he did the interests of the lender. It is therefore easily

seen that the alleged interest on the part of Mr. Van Dolson was not the requisite adverse interest necessary to negate the security for which good and valid consideration was paid. Further, to impute such an interest to Mr. Van Dolson would necessarily require the negation of the long standing doctrine of *Femme Sole* and impute the acts of the husband to the wife.

It is therefore respectfully submitted that the correct decision was initially reached by the Referee who alone has had the opportunity to weigh the credibility of the witnesses and to determine the real truth in this matter, and was correctly affirmed by the District Judge.

Once the lack of the necessary adverse interest is determined, no further inquiry is necessary at this point nor is any further inquiry pertinent to the issue.

However, it is well to note that the correct statement of law has been aptly quoted in the order of the Honorable Judge Hemphill, dated December 18, 1967.

This law applied to the facts as adduced from the testimony is such that the appellant's contention is without merit. The burden of proving that the actions of Mr. Van Dolson, even if found to be an interested director, were fair and in good faith and consistent with the best interests of the corporation, has been amply met as required by law, and it is earnestly submitted that the mortgage in question is valid and must stand.

CONCLUSION

It is respectfully submitted that the application for certiorari herein is based entirely on questions of South Carolina Law and presents no Federal Question of Substance. In these circumstances it would appear that the petition for the Writ of Certiorari must be dismissed.

It is further respectfully submitted that there is nothing in the record to justify a reversal. The transcript, if thoroughly studied, can and does produce only one reasonable inference and that is that the only true and equitable result possible has been reached and has been affirmed. That the Order of Judge Hemphill, dated December 18, 1967, is properly based upon the applicable law and the found facts, that it is correct and should be affirmed by this Court.

Respectfully submitted,

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